VEF

The emerging market fintech investor

Rupeek & the Indian Gold Lending Market

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This research report is a continuation of our series of publications sharing insights on portfolio companies and their ecosystems. In this report, we provide an overview of the gold lending industry, the competitive landscape, and we review why Rupeek is well-placed to continue winning market share.

Cover photo: iStock.com/Nikhil Patil. Photos: Rupeek.

Introduction

At VEF, we are big proponents of digital, asset-backed lending. It is an excellent fit in Emerging Markets as individuals are more likely to own assets outright (home/cars/gold) than have access to large pools of savings. They also tend to be underleveraged with limited credit histories and credit access. Creditas, a VEF portfolio company, is the best example of this we have come across. It is a digital asset-backed lender in the auto, home and payroll segments in Brazil, in which we originally invested in 2017. It is consistently taking market share, has reached large scale (>USD 1 bln loan book) and is on a path to both cash flow breakeven and an IPO.

We saw many parallels to Brazil in the gold loan market in India, which supported our investment case for Rupeek, the country's fastest-growing digital platform for secured lending. Gold lending is a scale market, underpinned by sizeable annual household savings and an affinity to gold that is unmatched globally.

Although India has made substantial progress in accelerating financial inclusion (VEF has previously written about this here), there remains a sizeable credit gap, estimated at c. USD 1 trln.[1]

Rupeek is a secured lender helping to close this gap. It is scaling rapidly in part due to the large degree of trust its 'doorstep' offering establishes with borrowers: it offers a personal service to the borrower, provides greater security of gold in transit and has no hidden fees. This has resulted in high repeat rates amongst its customer base and an overall superior value proposition.

1. Source: CRISIL Research for MSMEs (Medium and Small Enterprises).

Photo: Jayesh Jalodara (Unsplash)

The Indian gold lending opportunity

Household affinity with gold

Indian households are historically large savers, with the majority of these savings held in physical assets like gold. Indians are one of the largest consumers of gold globally. We estimate Indian households own c. USD 1.6 trln of physical gold, but only USD 193 bln of this is used as collateral in the gold loan market, representing 12.2% penetration on the base of India's 27,000 tonne household gold holdings.

Indians have an affinity with gold for multiple reasons:

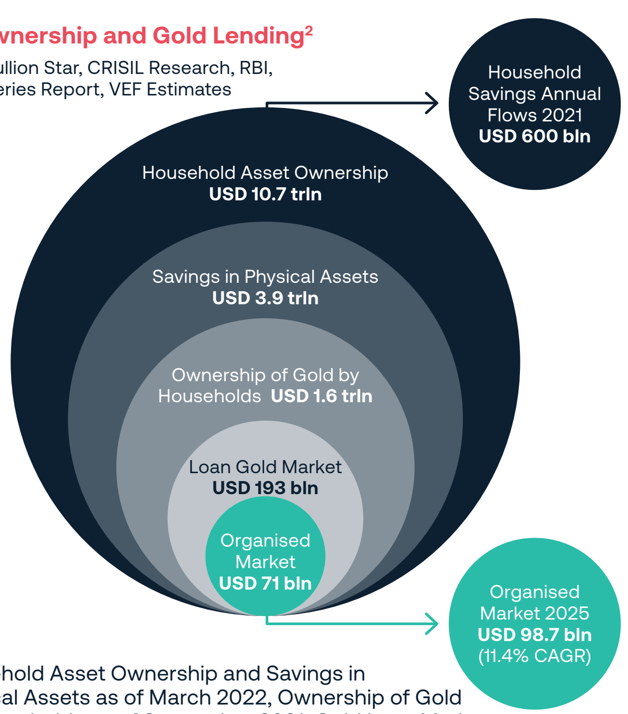
- **Religious connotations**: Gold is an integral part of religious ceremonies in India, regardless of religion.
- **Gifting**: Gifting gold is considered auspicious in India.
- **Status**: People across all classes like to show their gold off.
- **Investment**: Gold is considered a safe investment, protecting savings through different cycles.

On this latter point, we found that gold protects India household savings from increases in interest rates and broader equity market declines:

- Over five different periods in the last 20 years where interest rates increase, gold prices rose by an average of 18.5% in the six month period prior to the hiking start and six months after the last hike. *Note:* The organised gold-loan market typically grows in line with the gold price.
- When the Indian equity market falls, gold in rupees generally rises.

Gold Ownership and Gold Lending[2]

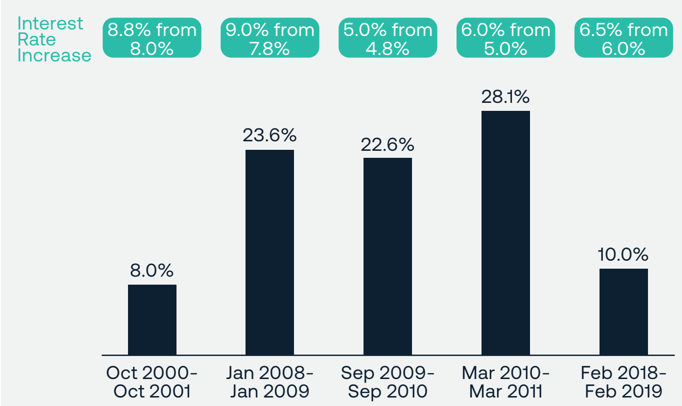
Source: Bullion Star, CRISIL Research, RBI, AMFI, Jefferies Report, VEF Estimates



2. Household Asset Ownership and Savings in Physical Assets as of March 2022, Ownership of Gold by Households as of September 2021, Gold Loan Market and Organised Market as of FY2022. Household Savings Annual Flows is a VEF estimate for FY2021.

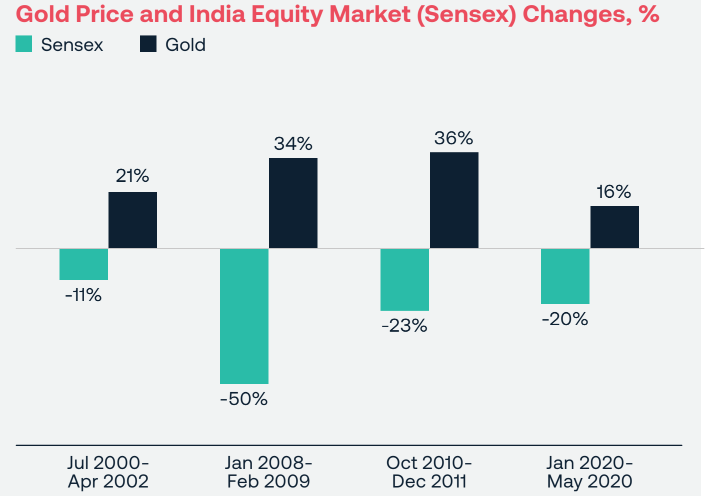
Gold Price Changes In Periods Of Rising Rates, %

(6 months prior the rate hike to 6 months after)



Source: World Bank, RBI

Gold Price and India Equity Market (Sensex) Changes, %



Source: Gold World Counsel, Sensex

The gold loan market

The Indian gold loan market can be divided into two segments—organised (37% of total) and unorganised (63%). The organised segment includes banks (public, private, co-operative, and small finance banks), Non-Bank Financial Companies (NBFCs), and Nidhi[3] companies. The unorganised gold loan segment comprises primarily individuals who provide secured loans to borrowers by keeping gold as collateral, and is characterised by high short-term rates, high fraud rates, non-standard collection policies, and has persistently lost share to the organised segment.

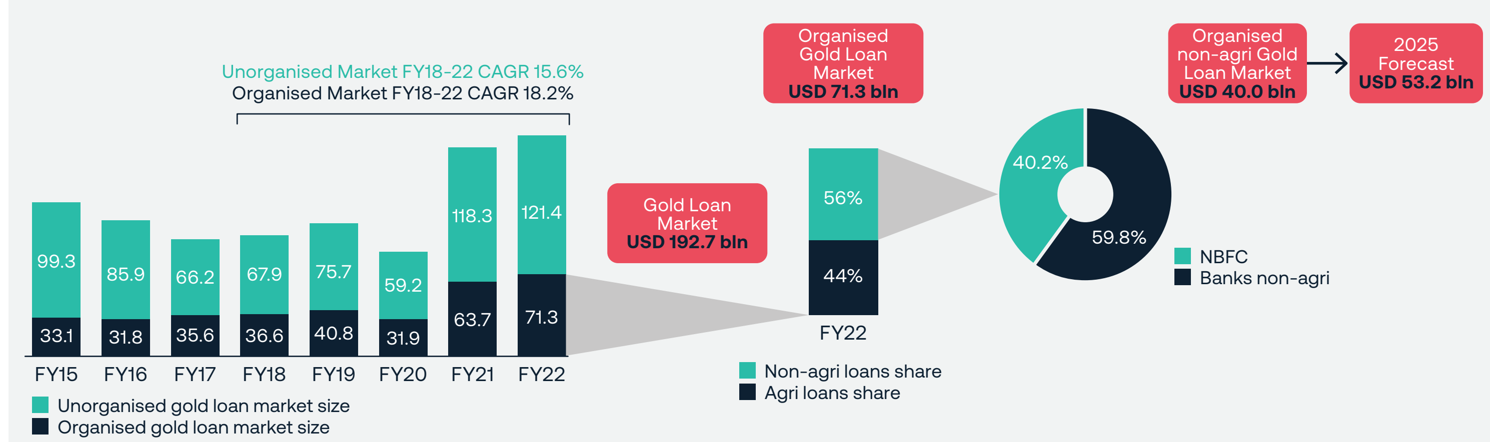
In the organised gold loan segment, agricultural loans represent c. 45% of total, and can be attributed mostly to banks who primarily consider gold loans as a means of meeting their Priority Sector Lending (PSL) requirements by offering them for agriculture and other PSL[4] purposes.

Gold loans are essentially small ticket business loans: 62% of loans are given to small businesses, 65% of gold loans are of less than USD 700 in value and are mostly originated in tier II, III cities and rural areas.[5]

Our focus in this report is on the organised non-agricultural gold loan market (56% of the organised market), which is estimated to be USD 40 bln.

The potential for gold lending to grow is sizeable, taking into account that (1) total annual household savings (income less expenditures and tax) generated by households are c. USD 600 bln, and (2) gold loan penetration rates can increase, in part due to new-age Fintechs such as Rupeek, increasing consumer's access to the product, primarily through doorstep lending. Increasing the penetration rate of gold loans helps improve financial inclusion whilst at the same time utilises a large, otherwise unproductive asset to drive meaningful economic growth. Rupeek is a structural play on Indian households saving more gold, and the growth of the gold loan market.

Organised and Unorganised Gold Loan Market Share



Source: VEF estimates, FedFina, IIFL Finance, KPMG, Companies' Investor Presentation

3. A Nidhi Company is an NBFC (which does not required RBI approval) that works for its members by accepting deposits and lending funds.
4. PSL is a form of directed lending as per RBI guidelines. Many public sector banks offer these and take gold as security predominantly in rural areas, classified as agricultural loan.

5. IFIL Finance.

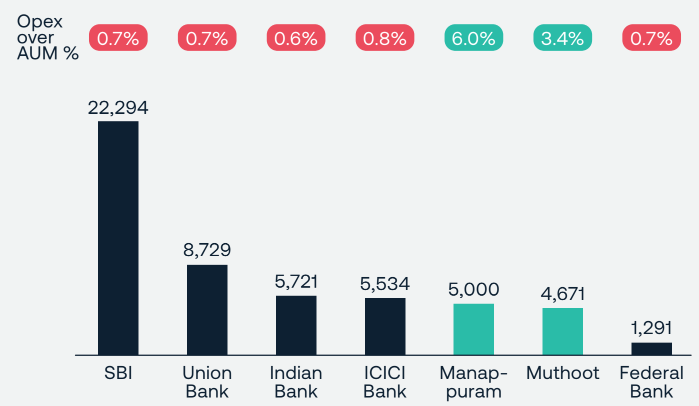
Competitive landscape

Within the organised share of the gold loan market, growth rates have been healthy (18% CAGR 2018-’22) and banks have historically dominated (c. 60% market share). In the following section, we review the main players divided between NBFCs, the banks and Fintechs (Rupeek).

NBFCs

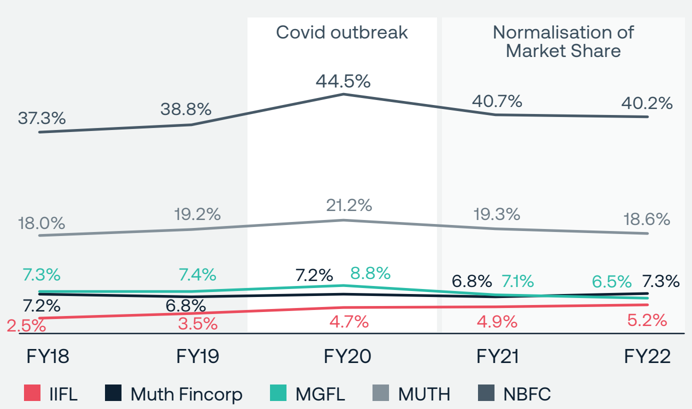
There are two dominant NBFCs operating in the gold lending space in India – Muthoot and Manappuram – both listed on the stock market with a long history in gold lending. These specialist gold lending NBFCs have been successful in taking market share from banks historically thanks to some major relative advantages – faster underwriting/origination and repayment flexibility. Relative to the size of assets, they have large branch networks (comparable to the largest private and state banks), and all of their branches are dedicated to gold lending (this is not the case for traditional banks). NBFCs saw a spike in market share during the COVID period, as most banks pulled back aggressively from all lending. NBFCs went from a market share of less than 40% in 2019 to 44.5% during 2020. Both Muthoot and Manappuram have historically had high returns and strong growth dynamics, although competitive intensity has increased of late.

Banks and NBFCs Number of Branches Q1FY23



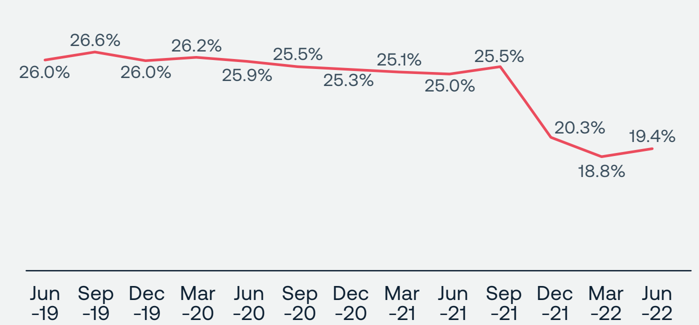
Source: Companies’ Investor Presentations

NBFC’s Organised Gold Loan Market Share (Non-agri)[6]



Source: VEF estimates, FedFina, IIFL Finance, KPMG, Companies’ Investor Presentations

Manappuram Quarterly Net Yield on Gold Loan Portfolio



Source: Manappuram Investor Presentation

6. Muthoot Finance (MUTH), Manappuram (MGFL),IIFL Finance (IIFL), Muthoot FinCorp (Muth Fincorp). Muthoot FinCorp and Muthoot Finance are two separate companies without any common promoters. While the two parameters are family, cousins, they have no mutual business relations.

Banks

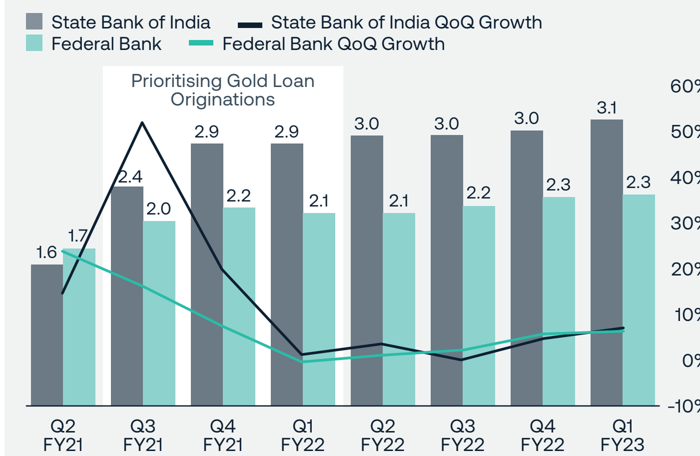
Banks with the largest loan portfolios include Union Bank, State Bank of India, Indian Bank, ICICI and Federal Bank. Partly in response to a cautionary approach to credit origination during COVID, the RBI[7] increased maximum loan-to-value limits for gold loans in October 2020 from 75% to 90% for banks (but not NBFCs). As a result, banks with abundant liquidity, such as those mentioned above, grew gold loans rapidly – in the second half of 2021 and into 2022, banks like State Bank of India and Federal Bank began to prioritise gold loan originations over other retail or MSME loans.

There are many factors that influence the extent to which banks prioritise gold loan origination (or not), including having the ability to originate and service in-house. We think that the most important is excess liquidity, and the relative spread attainable. It is no coincidence that the banks with the lowest loans-to-deposits ratio are the largest gold lenders. These banks deploy excess liquidity into gold lending, which is inherently low-risk.

This is due to the more favourable treatment of gold loans from a risk-weighting perspective. Similar to treasuries, gold loans carry a zero-risk weighting compared to average risk weights for other retail loans of 50–100%. Banks typically assess where to place excess liquidity between gold and treasuries. As risk-free yields have declined, banks with the most liquidity (the lowest loans-to-deposits ratio) have sharply reallocated liquidity to higher-yielding gold loans.

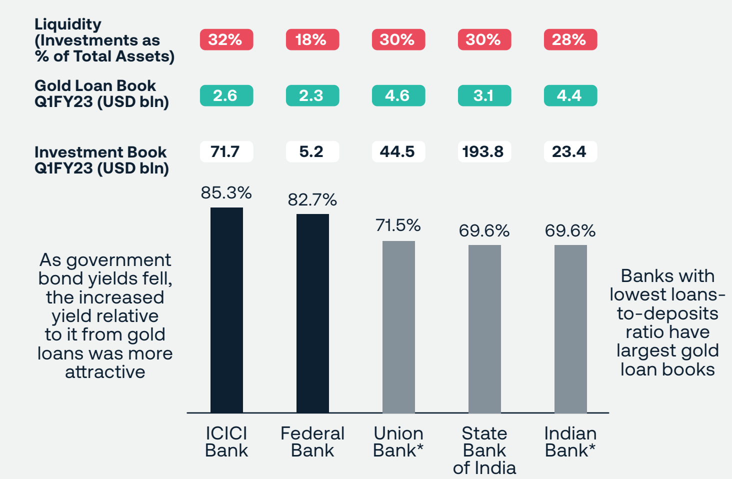
7. Reserve Bank of India.

State Bank of India and Federal Bank Gold Loan Book Growth
(USD Bln)



Source: State Bank of India and Federal Bank Investor Presentations

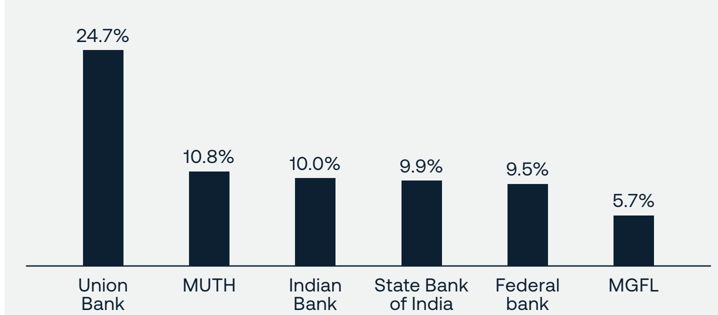
Banks’ Loans-to-Deposit Ratio (Q1FY23)
(Investment book includes SLR investments, shares, and debentures/certificate of deposits/mutual funds/commercial paper)



Source: Companies’ Investor Presentation

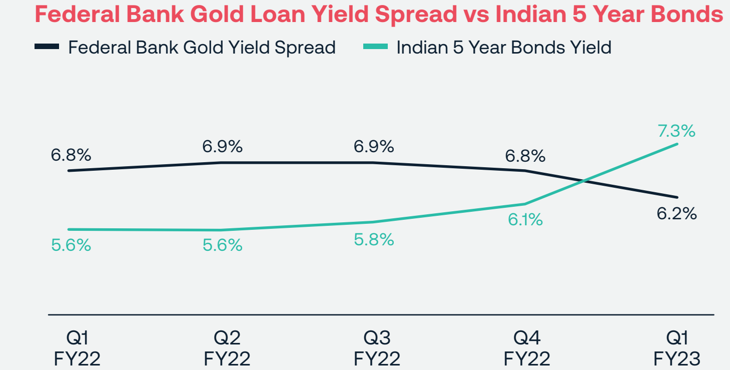
* Domestic only.

Gold Loan Book FY21-FY22 YoY Growth



Source: Companies’ Investor Presentation

Federal Bank Gold Loan Yield Spread vs Indian 5 Year Bonds



Source: Federal Bank’ Investor Presentation, India 5 Year Bond History

Rupeek

Rupeek is India's leading asset-backed digital lending platform. It offers gold-collateralised loans to customers both at the doorstep and nearby branches at the lowest interest rates in the industry. Rupeek's product and tech-led platform make it simple, fast, and transparent for customers to secure gold loans without leaving the comfort of their homes. It is led by a strong team in a large TAM with traction at excellent unit economics.

Although Rupeek competes with both Muthoot and Manappuram, its origination model is different: Rupeek originates the majority of loans (acquiring the customer, conducting KYC, screening them and assessing the collateral) straight onto bank partner balance sheets given a pre-agreed set of parameters. Rupeek then continues to service the loan and manage the customer relationship as well as completing repossession and auctioning of collateral for defaulted loans. Rupeek has secured a lower cost of funding with their partner banks versus the NBFCs and passed on these savings to the borrowers in the form of lower interest rates. With these partnerships, credit risk is shared between Rupeek and their partners, with both compensated with a share of the economics. The lower credit risk assumed by Rupeek was an attractive characteristic to VEF, given the significantly better risk/reward versus many of the unsecured credit opportunities we explored in India.

Secured lending is complex in nature and is traditionally one of the most human process-intensive functions within banking. Current market solutions are far from perfect, and the big opportunity for the growth of secured lending is to use technology to automate and standardise the process, which we have seen implemented effectively at Creditas.

The market is broken: existing players have a far from perfect functional proposition

	Banks	NBFCs	Pawn Brokers
Interest Rate (annualised)	9–13%	25–30%	28–50%
Repayment Terms	Non-flexible	Flexible	Stringent
Loan to Value	Low	High	High
Turn around time	> 1 day	Immediate	Immediate
Digital access	Weak	Weak	Non-existent
Product Focus	Low	High	High
Ops intensity + cost + capex	High	High	Non-scalable
Market Share	35%		65%

Source: Rupeek

Riding on technology and product innovation, Rupeek has turned the traditional experience of applying at a branch on its head through its asset-light doorstep service.

Rupeek's User Journey

Schedule	Transact	Storage	Release
Customer applies for a gold loan (website, call, app)	Loan manager authenticates the customer and performs KYC	Gold is packed in tamper proof packaging	Repayment
Transaction scheduled	Gold appraisal, pledge, card issued	Gold transfer to bank branch	Release of gold post payment verification
Loan manager sent to customer's home	Amount disbursed to customer's account	Gold appraisal and storage	Release manager delivers gold back to customer

Source: Rupeek

The process involves an at-home scheduled meeting upon receipt of a loan application via the Rupeek app/website. A Rupeek loan agent visits the customer with a gold appraisal kit and the necessary tools to measure the purity of the gold. After this due diligence and a credit check, the loan is processed digitally and the amount is transferred instantly to the customer's bank account.

After the loan is transferred, the gold is packed in tamper-proof packets and transported to the nearest Rupeek branch in a GPS-enabled secured box, which is tracked on a real-time basis until the collateral is deposited in the lender's vault.

The next leg of Rupeek's journey will see rapid scaling of originations with the introduction of a second distribution avenue – a branch-led model, using partner bank branches as customer access points.

Rupeek's mission is to provide access to credit to those who need it most. They want to build a business of scale to offer collateral-backed lending to millions of borrowers on much more reasonable terms than currently available through a digital experience. The VEF investment team strongly identifies with this mission, and we are excited to see them thrive in their journey to transform credit origination in India.

Why it matters to borrowers

- Fair, not one size fit all
- Payable when able
- Maximize absolute ROIC for small businesses
- Certainty of loans/emergency
- Transparency and convenience
- Bank branches are incentivised on book size, CASA and fee income
- Gold loans are small ticket size, short tenure and highly ops intensive

Rupeek's ingredients for success

VEF co-led Rupeek's Series E fundraise in Q4 '20, and participated in an extension to this in August 2022, investing a total of USD 14 mln for a 2.4% stake. With more capital, and an expanded number of bank partners, Rupeek is set to maintain its cost of funding advantage to scale origination growth. Rupeek's business is starting to break out as it scales to multiple new cities.

Its founder and CEO is Sumit Maniyar, one of the best founders we have come across in India to date. He has huge ambitions, but fuelled by very pure intentions and is driven to make a very big impact, all of which has helped him attract an impressive senior team.

We believe that Rupeek will continue to succeed in the gold loan market due to its strong customer retention, unique capital supply strategy and leading unit economics. NBFC incumbents have limited flexibility to competitively respond.

Strong user behaviour and trust

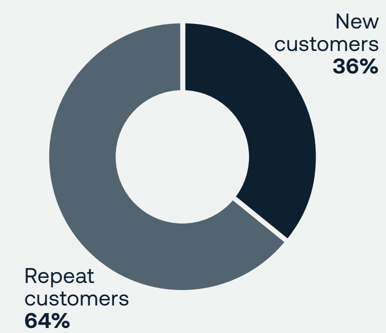
When availing of a loan from Rupeek, the borrower must pledge their gold, which often comes in the form of ornaments or jewellery, carrying strong emotional association and sentimental value to the customer. This requires a great degree of trust to be built with the customer.

Rupeek's doorstep offering builds consumer trust:

- It provides a more personal service to the borrower by coming to his/her home to assess the collateral;
- Interest rates offered to the consumer are significantly lower than the unorganised sector, and lower than NBFC gold lenders;
- The risk of fraud is lower to the customer, as a security van transports the gold to the branch instead of the customer having to bring the gold into the branch themselves.
- There are no hidden fees or repayment penalties.

The superior value proposition offered by Rupeek has translated into high repeat rates and a high NPS. This customer stickiness has contributed to rapid origination growth and market share gains versus incumbents – who experienced a substantial fall in originations and market share in FY2021 (with some recovery starting Q2FY22).

Rupeek's Repeat Customer Rates 2023E

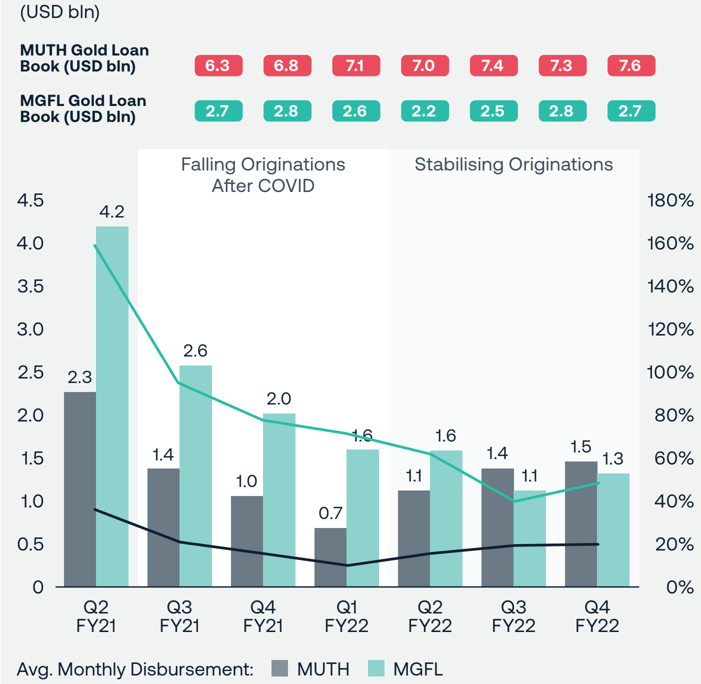


Customers can easily make repayments for their loans, view jewels pledged for their loans, and release all or part of jewels whenever they need them for festivals or other occasions with just a few clicks within Rupeek's app.

This becomes a hassle-free experience for customers where the entire process of getting the loan and releasing jewels when they need it becomes super easy without having to step out of the comfort of their home.

Source: VEF, Rupeek

NBFC's Disbursements
(USD bln)



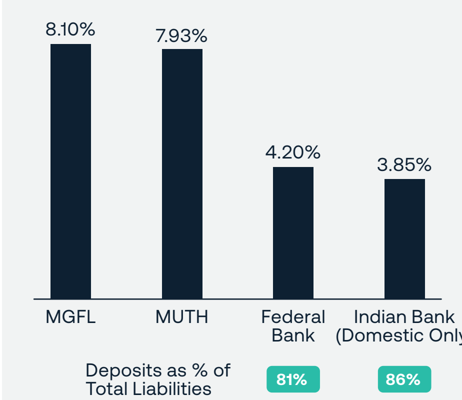
Source: Companies' Investor Presentation

Unique capital supply strategy

Banks have a low cost of capital relative to the NBFCs but lack product and operational focus when it comes to gold loans. Rupeek has made big banks its allies, partnering with them to access their balance sheet while providing access to Rupeek's 'plug-and-play' gold loan stack which essentially allows them to enjoy high RoAs and see their gold loan portfolio grow. This affords Rupeek the ability to scale an asset-light model, with strong unit economics whilst also delivering sizeable interest rate savings to the customer. NBFC funding is much more concentrated in wholesale debt, and hence is higher cost.

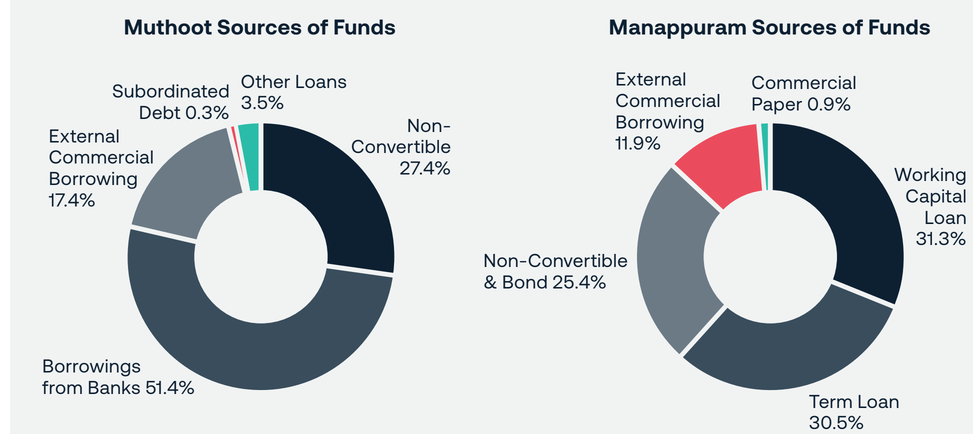
Rupeek

Cost of Funds (Q1FY23) %



Source: Companies' Investor Presentation

Muthoot and Manappuram Sources of Funds Split



Source: Companies' Investor Presentation

Banks benefit from working with Rupeek as they receive c. 9% returns (versus the risk-free rate c. 7.4%), and stand to build a large gold loan book. This would not be possible without Rupeek, as the co-lending model incurs lower operating costs for banks while increasing their catchment area.

Rupeek is operationally integrated with their bank partners on a branch and regional level, and at top management level. It is the only Fintech in India which we have come across that has successfully spanned the incumbent banking system and alternative lenders with its unique ability to integrate with disparate technology systems and interfaces. Many of these systems have weak reliability and scalability, and are inherently complex. These integrations are building a significant competitive moat around Rupeek.

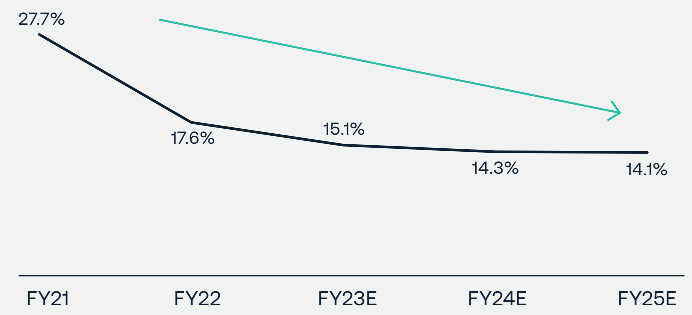
Leading unit economics

Rupeek originates the vast majority of its loans off-balance sheet straight onto bank partner balance sheets. This affords it two big unit economic advantages versus Muthoot and Manappuram: (1) It has a lower cost of funds and (2) It retains limited credit risk.

On a unit basis, Rupeek is profitable within their first transaction, taking into account CAC, fulfilment expenses, gold storage costs, etc, with room to optimise on the process.

Rupeek and other banks' success in taking share within the organised lending market can be seen through the deterioration in unit economics for both listed NBFC companies.

Manappuram RoE Forecast



Source: CLSA Research

Both listed NBFCs are experiencing an increase in the cost of funds: Manappuram's cost of funds increased 10bps QoQ in the most recent quarter to 8.1%, and management expects a similar increase next quarter too. Banks are typically deposit-funded, and their cost of funds are less sensitive to interest rate increases as a result.

The challenge for these companies, which remains the opportunity for Rupeek and their partners, is that competition is not going away any time soon. Rupeek's competitive threat will likely persist as it scales up new bank partners and expands into a large number of new cities. New bank partners will bring further diversity to its funding mix, and will likely deliver some interest expense savings, limiting the amount of positive re-pricing possible for the incumbents.

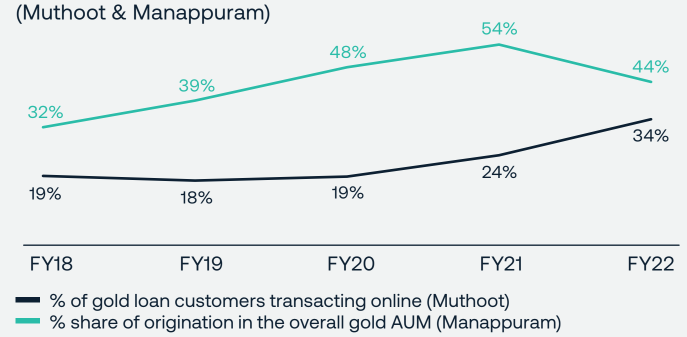
Competitors are not to be counted out

The era of super-normal profits may be over for both Muthoot and Manappuram: both companies may accept a lower level of profitability, and/or balance this with a renewed focus on achieving efficiency gains and perhaps some hope that competitive intensity will ease.

Costs are largely fixed (60%+), and are mostly associated with their sizeable branch footprint, which are larger in Manappuram than Muthoot looking at costs as a percentage of AuM (6.0% vs. 3.4%).

Continued product innovation from Muthoot and Manappuram could allow them to compete more effectively with Fintechs like Rupeek. Both companies have introduced their own version of doorstep gold loans for larger ticket sizes and digital gold loan origination, although disbursements still occur at the branch level which limits efficiency gains.

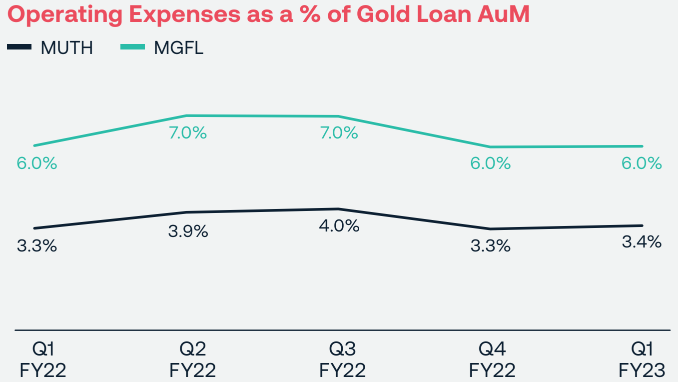
Share of Digital Gold Loans to Total Gold Loans Over Time
(Muthoot & Manappuram)



Source: Companies' Investor Presentation

We would not count out the two listed players in terms of their ability to respond competitively to the banks. They are highly profitable, with strong distribution including in some of the most remote areas in India, and are gradually building their own digital capabilities.

Operating Expenses as a % of Gold Loan AuM



Source: Companies' Investor Presentation

Historically, large banks centred gold lending activities more in large cities carrying higher average loan sizes whereas the NBFCs have been more focused on tertiary cities and rural parts of India with on average lower loan sizes. One implication of this is the high cost to serve of NBFCs: the smaller the ticket size, the more likely the borrower wants an emergency loan which requires a rapid turnaround time and a great degree of cash handling. The recent lower loan yields reported by Muthoot and Manappuram is in-part a reflection of originating higher average loan sizes, competing more head-on with the banks. A more structural shift to higher ticket loans should improve NBFC efficiency.

The Future of Rupeek

The future of Rupeek will be characterised by further scaling its core product to establish a large and loyal customer base, and building a suite of additional products and services that accelerate access to credit via collateralised gold.

Scaling the core product

Rupeek has plans to scale its funding base through additional bank partners, and eventually utilising the securitisation markets in India. This will both diversify its funding mix, and ensure that its funding cost advantage over incumbents is maintained. It should also result in greater efficiency as Rupeek leverages bank branch networks for distribution where it has plans to expand aggressively into a large number of new cities. Partnerships will likely feature in broadening its distribution capabilities, including with jewellers.

Additional products and services

As Rupeek builds a loyal and scale customer base, it plans to accelerate access to credit by introducing some new products and services backed by gold collateral. The most exciting near-term product in the market today is Rupeek Quick, a gold-backed credit card launched in Q4 '21. This is an overdraft-style facility on cards enabling customers to withdraw at low charges from ATMs (many credit cards come with high 3–7% withdrawal charges and low cash withdrawal limits). Loan yields are higher than its term loan core product. In addition, there is no incremental operational expense or customer acquisition cost involved in scaling it, and the cards are issued for free. The availability and affordability of instant credit via card is very appealing to customers and it is a clear and unique point of differentiation for Rupeek in the customer's mind.

Challenges to surmount

There are three main challenges facing Rupeek in the medium-term:

- Broadening its distribution footprint to bank branches carries execution and operational risks at scale.
- Fraud risk associated with doorstep lending is a constant threat, and something Rupeek has managed well thus far.
- Increased regulatory scrutiny surrounding (1) The deepening relationship between Fintechs and banks (2) Risk-weighting of gold loans by banks.

We believe Rupeek has the leadership, the right business model and a dynamic strategy to meet these medium-term challenges. We are excited to support Rupeek on its journey to narrow India's credit gap through gold lending.

Building deep, mass market capability is imperative for creating a long lasting financial services brand

Expansion of distribution capability				Expansion of offerings and use cases			
	Doorstep	**Bank**	**Pawn brokers**		**Rupeek Quick**	**Gold Cards**	**Gold ATM**
Pain Points	• Affluent TG • Wants privacy & convenience	• Formal economy • Low digital savvy • Poor experience	• Informal economy • Expensive	**Rupeek benefits**	• Latent demand expansion • Operating cost reduction	• Latent demand expansion • MDR revenue	• Operating cost reduction • Better distribution
Key Offerings	• Doorstep, digital first, stigma free	• Higher service level	• Cheaper balance sheet	**Customer benefits**	• Instant credit • Micro payments	• Credit free period • Micro payments • Rewards	• Convenience • Cheaper
Process high double-digit share of country's gold loan disbursals through Rupeek platform							

Source: Rupeek

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